Decision ___________________

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902 E) For Approval to Enter into a New Electric Resource Contract with the San Diego County Water Authority and For Approval of the Cost Recovery and Ratemaking Mechanisms Associated Therewith.	Application 04-04-042 (Filed April 2, 2004)

OPINION GRANTING APPROVAL FOR SAN DIEGO GAS & ELECTRIC COMPANY TO ENTER INTO ELECTRIC RESOURCE CONTRACT WITH THE SAN DIEGO COUNTY WATER AUTHORITY

Summary

The Commission grants the application of San Diego Gas & Electric Company (SDG&E) for authority to enter into a new electric resource contract with the San Diego County Water Authority (Water Authority) and adopts the proposed cost recovery and ratemaking mechanisms. This contract governs SDG&E's purchase of capacity from the Water Authority's proposed 40 MW Olivenhain-Hodges Pumped Hydroelectric Storage Facility (Hodges), and the cost recovery and ratemaking mechanisms will ensure that SDG&E recovers all costs related to the electric resource contract.

Applicable Law

SCE's application is made under Public Utilities Code Section 454.5(b)(7),[1] and Assembly Bill (AB) 57 which requires the Commission to provide an expedited review process whereby the upfront standards and criteria by which the acceptability and eligibility for rate recovery of the electric resource contract will be known by SDG&E before the utility executes the transaction.[2]

Responses to SDG&E's application were received from Pacific Gas and Electric Company (PG&E), the Office of Ratepayer Advocates (ORA), and the Utility Reform Network (TURN).

The Proposed Contract

The Water Authority is a public agency and political subdivision of the State of California serving the San Diego region as a wholesale supplier of water from the Colorado River and Northern California. The Water Authority is developing the Hodges pumped hydroelectric storage facility to enhance the capabilities of its water delivery system. The facility is scheduled to be in service in January 2008.

The Hodges Agreement provides for SDG&E to purchase the full 40 MW of Hodges electric capacity for a term of 25 years, and the Water Authority will complete an essential water project to ensure that water is available during

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[1] All statutory references are to the California Public Utilities Code (Pub. Util. Code) unless otherwise noted.

[2] SDG&E originally filed this application on April 2, 2004, as a motion in the procurement docket, R 01-10-024, and PG&E, ORA, and TURN filed responses to the motion. Pursuant to an Administrative Law Judge (ALJ) ruling issued on May 18, 2004, this motion was removed from the procurement docket and moved to a new application docket. The PG&E, ORA, and TURN responses were deemed timely filed in the application docket.

emergencies to the greater San Diego area. SDG&E will be the scheduling coordinator for all Hodges generation and pumping, including the Water Authority's requirements. The Water Authority, however, maintains priority water use in the event of a water emergency. The Water Authority must reimburse SDG&E for all imbalance energy costs, including California Independent System Operator (CAISO) penalties, incurred as a result of the Water Authority's failure to comply with valid dispatch orders or to abide by the CAISO tariff.

Responses

PG&E takes "an interest" in SDG&E's application only because SDG&E, in its resource planning process,[3] asked the Commission to reallocate from SDG&E to PG&E the Sunrise contract held by the California Department of Water Resources. PG&E filed a response in this docket to reassert its position vis-à-vis the Sunrise contract that SDG&E should not request the addition of power resources and then claim that it has excess power with the Sunrise contract and ask that it be reallocated to PG&E.

TURN "conditionally" supports SDG&E's proposed contract with the Water Authority, but has some concerns about costs that might be a burden to bundled ratepayers. Specifically, TURN is worried that if there are future increases in the numbers of unbundled customers, the remaining bundled customers will have to pay for any stranded costs. To avoid this, TURN requests that the Commission condition its approval of the Hodges Agreement on having

[3] SDG&E's motion for approval of the winning electric resource contracts that followed a Request for Proposal (RFP), filed in the procurement docket, R.01-10-024.

all currently bundled customers pay for the cost of the contract for the 25-year life of the contract.

TURN also requests that the Commission not grant SDG&E compensation for the debt equivalence effect of the Hodges Agreement in this proceeding, but defer the issue to an appropriate proceeding.

ORA supports the approval of the Hodges Agreement and its cost recovery, subject to recovery in the energy resource recovery account (ERRA) proceeding, and without the project being deemed a "no regrets" project as requested by SDG&E.

Environmental Matters

California Environmental Quality Act (CEQA) Compliance

SDG&E asserts that its requests in this application do not invoke CEQA, because CEQA applies to discretionary projects to be carried out or approved by public agencies. Projects are defined generally as activities that may cause either a direct physical change in the environment, or a reasonably foreseeable indirect change in the environment.[4] In its application, SDG&E only requests Commission authority to perform under the Hodges Agreement and the utility's performance will not result in any physical change to the environment because it is a preliminary step towards the Water Authority's further development of the project. In its application, the utility provides points and authorities in support of its position that CEQA does not apply since all the Commission will be doing is approving SDG&E's legal and financial responsibilities under the contract, and not approving a "project" as defined by

[4] Public Resources Code Section 21065; 14 California Code of Regulations Section 15378(a).

CEQA. No party challenged SDG&E's argument that CEQA does not apply to this application and we agree that no further review under CEQA is necessary for us to act on this application.

Revenue Treatment

SDG&E requests that the Commission authorize it to recover all costs associated with the Hodges Agreement. SDG&E shall pay the Water Authority $65/kW-year (fixed) plus $5/kW-year (escalated) for the generation capacity starting January 1, 2008. The escalation will be determined annually based on the change in the Producer Price Index (PPI) published by the U.S. Department of Commerce, Bureau of Labor Statistics, and capped at 2.5%. If in any year the increase exceeds the 2.5% cap, SDG&E will only pay 50% of the amount above 2.5%.

SDG&E will pay a variable Operations and Maintenance (O&M) rate of $2/MWh for all energy generated for SDG&E, escalating annually at the change in the PPI capped at 2.5%, under the same condition described above.

SDG&E proposes to recover the costs associated with the Hodges Agreement through its ERRA, which authorizes the utility to recover the energy and related costs associated with providing electricity to its bundled service customers. All payments flowing to SDG&E from the Water Authority shall flow through the ERRA to the benefit of SDG&E customers.

SDG&E is not requesting that the Commission grant the utility specific compensation for the debt equivalence effect of the Hodges Application or to resolve the general debt equivalence issue in this application. The utility will pursue the debt equivalence issue in proceedings as necessary and/or in the cost of capital proceedings.

Discussion

The Water Authority is developing the Hodges pumped hydroelectric storage facility to enhance the capabilities of its water delivery system, including its ability to store 20,000 acre-feet of water for use during a water emergency, maintain more consistent reservoir levels, and capture runoff water before it spills into the ocean during rainy seasons. SDG&E presented testimony that the addition of this resource in San Diego is an economic way to meet a portion of the utility customer's growing resource needs in 2008 and beyond for the following reasons:

- The expected net benefits are approximately 20-25% lower than a peaker plant—even if the unit does not count toward reliability must run (RMR) needs, and the benefits will be higher if it does count toward RMR needs;
- The energy benefits, including the variable O&M costs, are expected to be about $500,000/year, with the range being between $200,000 to $1 million;
- Operationally, SDG&E will direct the operations of Hodges, including planning the optimization of water transfers between Lake Hodges and the Olivenhain reservoir and directing power production/consumption, consistent with all applicable water limitations;
- SDG&E will integrate the Water Authority's electric dispatch needs associated with the need to move water so that the power needed for water movement does not interfere with SDG&E's use of the project to meet peak power needs;
- Hodges will be available for dispatch by SDG&E in the CAISO Day Ahead market through to the Hour Ahead market;
- It is anticipated that the Water Authority's needs for the water during a water emergency will be infrequent, and SDG&E otherwise retains all the rights to the water.

In Decision (D.) 04-01-050, the Commission states that "[a]ny long-term commitments brought to the Commission prior to adoption of the revised 2004 long-term plans should be reviewed within the context of the April filed plans and should make [a] "no regrets" showing."[5] SDG&E presents arguments in its application that the Hodges Agreement meets the "no regrets" standard because it is highly cost-effective, large enough to provide measurable customer benefit while being small enough to minimize long term commitment risk, provides resource flexibility and diversity, the utility may terminate the agreement if the project fails to perform as expected, and it is a one time opportunity that could go to a buyer outside the San Diego area if SDG&E does not purchase it at a competitive price.

ORA, while supporting the agreement and cost recovery, objects to this project falling under the "no regrets" test. ORA believes that the "no regrets" policy is intended to apply to unquestionably large projects, such as a 300-500 MW combined cycle facility, and to projects that are "highly" cost-effective. Based on the numbers presented in SDG&E's application, ORA does not believe that this project, with a benefit cost ratio of only 1.21, meets the "highly" cost effective ratio of 1.7 – 2.0 or greater that is typical of a large baseload generation plant.

We are persuaded by ORA's arguments, and will approve the Hodges Agreement, but without determining that it meets the "no regrets" policy. This is a small, 40MW facility with sufficient built-in safe guards to protect the consumers and rate payers of SDG&E. In particular, SDG&E has the right to

[5] D. 04-01-050, mimeo at p. 92.

terminate the agreement if the project fails to perform as projected or expected. In light of this, we will not adopt the TURN proposal to have all bundled ratepayers pay for the agreement for its 25-year life.

Approving the Hodges Agreement will augment and provide diversity to SDG&E's energy resource portfolio with a pumped hydro-electric resource, is consistent with SDG&E's long-term resource plan, will benefit consumers by providing energy cost savings, is small enough that there is minimal long-term commitment risk to ratepayers, and is in the public interest.

Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

Procedural Background; Categorization

SCE filed this application on April 2, 2004. Resolution ALJ 176-3134. issued May 27, 2004, specified that this is a ratesetting proceeding and that no hearings are necessary. We confirm the categorization that this is a ratesetting proceeding and that no hearings are necessary.

Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Carol A. Brown is the assigned ALJ in this proceeding.

Findings of Fact

1. The proposed agreement between SDG&E and the Water Authority, the Hodges Agreement, allows SDG&E to purchase 40MW of capacity from the Olivenhain-Hodges Pumped Hydroelectric Storage Facility for a term of 25 years, and the Water Authority will complete an essential water project to ensure that water is available during emergencies to the greater San Diego area.

2. Costs associated with the Hodges Agreement shall be recovered by SDG&E through its Energy Resource Recovery Account (ERRA).

3. The Hodges Agreement will provide SDG&E with pumped hydroelectric power that will diversify the utility's energy resource portfolio.

4. Commitment risk to SDG&E ratepayers is minimized since SDG&E can terminate the agreement if the project fails to perform as expected.

5. No further review under CEQA is necessary for this Commission to act on this application since we are not approving a "project" as defined by CEQA.

6. There is no known opposition to granting the authorization requested.

Conclusions of Law

1. It is reasonable and in the public interest to approve the Hodges Agreement.

2. It is reasonable that SDG&E recover the energy and related costs through its ERRA account.

3. We find that the no further review under CEQA is necessary for us to act on this application.

4. This decision should be effective today in order to allow the Water Authority to meet its schedule to place orders for critical equipment with long lead times in order to meet the Hodges in-service date of January 2008.

O R D E R

IT IS ORDERED that:

1. The Application of San Diego Gas & Electric Company for authority to enter into a new electric resource contract, known as the Hodges Agreement, with the San Diego Water Authority is granted.

2. SDG&E shall recover the costs associated with the Hodges Agreement through its Energy Resource Recovery Account (ERRA).

3. SDG&E's execution of the Hodges Agreement is consistent with D.04-01-050 and other relevant Commission regulations and decisions.

4. Application 04-04-042 is closed.

This order is effective today.

Dated _____________________, at San Francisco, California.